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Petroleum Monitoring
Agency

Agence de surveillance
du secteur pétrolier

Measurement and Determination for Canadian Ownership and Control

A Proposal
November 21, 1980



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PREFACE

The National Energy Program (NEP), released on October 28, 1980, provided for a variety of measures which are intended to accelerate the achievement of the Government's ownership, control and security of supply goals. The Petroleum Monitoring Agency (PMA), established on August 1, 1980, will be responsible for the measurement of Canadian ownership rates (COR) and the determination of Canadian control.

This paper, which represents the Agency's present views on the methodology it will employ to measure an applicant's COR and determine Canadian control, has been prepared for discussion with the oil and gas industry and other interested parties.

The measures announced in the NEP to which a COR may be applied include:

- . Petroleum Incentives Program
Incentives to help firms that meet specified ownership and control criteria.
- . Natural Gas Bank
The establishment of a natural gas bank to provide cash flow to Canadian owned and controlled gas producers.
- . Export Applications
Consideration of Canadian ownership levels by The National Energy Board in considering export applications.
- . Canada Lands
The inclusion of a minimum 50 per cent ownership requirement in proposed legislation before a production licence may be granted.


It should be understood that the time frame for representation is quite short as enabling legislation must be introduced to give effect to the program. Therefore written submissions with respect to this paper will be considered if received by the Petroleum Monitoring Agency, 580 Booth Street, 14th Floor, Ottawa, K1A 0E4, not later than December 15, 1980.

Harold A. Renouf

Chairman

Ottawa

November 21, 1980



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INTRODUCTION

This paper presents for public comment a proposal for the measurement of Canadian ownership rates (COR) and the determination of Canadian control. The mechanisms outlined are in response to the requirements of the various programs described in the NEP. The following is a summary of the significant concepts on which the methodology is based.

Determination and Measurement Process

- . The process is voluntary. The applicant judges whether the benefits that may be accessed by way of the COR process are sufficiently attractive to warrant making an application.
- . The process is self-assessing. All initial calculations are done by the applicant by reference to enabling legislation, regulations and guidelines.
- . The process incorporates concepts of both ownership and control. An applicant must be able to establish a specified level of Canadian ownership and to demonstrate that it is Canadian controlled in order to qualify for certain programs announced in the NEP.

Who May Apply

- . Corporations incorporated in Canada.
- . Individuals who are citizens of Canada or landed immigrants.
- . Partnerships.
- . Trusts.

Fundamental Concepts Applicable to the COR Calculation

- . The COR will reflect beneficial ownership which may or may not be synonymous with the formal equity in an applicant. This provision would ensure that COR is not determined on the basis of an artificial equity which may not represent the true economic interests in the assets of the applicant.
- . The COR calculations will include a provision to look through non-arms-length ownership relationships to identify the beneficial owners. In arms-length situations the system limits the level of ownership chains which must be examined.
- . The address of record will not be sufficient to establish whether an ownership interest is held by Canadians. The test is the citizenship or immigration status of the individual investor, the partner or the trust beneficiary.

Administration

- . The Petroleum Monitoring Agency will administer the COR process.
- . Applications are effective for twelve months, at which time they must be renewed and are not restricted to the calendar year.
- . The applicant will be required to advise the PMA where there is change in Canadian control or a significant change in his COR.
- . Applications, to give effect to change in Canadian control or upward movements of COR, may be made at any time.
- . An advance rulings facility for proposed transactions will be provided.
- . A system of guidelines and interpretations will be instituted.
- . Anti-avoidance provisions will be written into the enabling legislation.
- . Applications will be accepted as soon as enabling legislation has been proclaimed.
- . COR determinations can be made retroactive to January 1, 1980.

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I. PURPOSE

As has been indicated, this paper is predicated on a need to measure Canadian ownership and determine Canadian control. What follows is a discussion outlining a methodology of how a qualified applicant would proceed to identify, measure and report his level of ownership and control status. It is recognized that these tasks are not simple and will thus add administrative responsibility to those who may wish to apply for a COR certificate. Notwithstanding this very valid concern it is necessary for the PMA to proceed with a methodology which facilitates the requirements of NEP measures such as the Petroleum Incentives Program, while recognizing the need for administrative feasibility.

II. OWNERSHIP

A. Qualification for COR

To apply for a COR the following provisions must be satisfied:

1. If a corporation, the applicant has been incorporated in Canada.
For this purpose companies continued into a provincial or federal jurisdiction would be considered to be incorporated in Canada.
2. If an individual, the applicant:
 - (i) is a Canadian citizen ordinarily resident in Canada, or
 - (ii) is a permanent resident, within the meaning of the Immigration Act.
3. A trust would be eligible to apply and would be measured as if it were a corporation.

4. A partnership would be eligible to apply and would be measured as if it were a corporation.
5. Participants in a joint venture would be considered as applicants for COR rather than the joint venture itself.

B. The Ownership Calculation Process

The determination of an applicant's COR would proceed according to the following steps:

1. The degree of Canadian ownership is determined separately for each class identified. (Appendix I - 1 sets out what could constitute a class.) The COR of the applicant is the lowest COR of the classes (see Appendix I - 2).
2. To determine the COR of each class the following procedures will apply:
 - (i) From the total number of ownership interests of the class deduct all such interests with foreign addresses (see Appendix I - 3).
 - (ii) Select at least 50% of the interests in the remaining pool of Canadian addresses ranked in order of magnitude. This selection must include all ownership interests equal to or greater than $1/2$ of 1% (a block) (see Appendix I - 4).
 - (iii) For each block determine the degree of Canadian beneficial ownership by multiplying the number of units of the block (e.g. shares) times the COR of the beneficial owner (see Appendix I - 5).

(iv) Aggregate the total number of Canadian ownership interests for the blocks identified above and calculate the percentage of Canadian beneficial ownership of the ownership interests so aggregated.

(v) Ownership interests not included in the measurement process as defined in (i) and (ii) above will be deemed to have the degree of Canadian ownership determined in (iv) above.

(vi) Add to the total number of Canadian ownership interests of the blocks determined in (iv) the number of deemed Canadian ownership interests determined in (v) above and calculate the degree of Canadian beneficial ownership of the class.

3. One of the fundamental issues in measuring Canadian ownership is that related to looking through the share register. The PMA is convinced that the principles of both beneficial economic ownership and effective control must be employed if Canadianization objectives are to be successful. To make this point, one need only think in terms of, for example, nominees holding shares in street form for an investor, in relation to the potential benefits from NEP spending programs. The PMA has therefore adopted a chain measurement concept as follows:

(i) The degree of Canadian beneficial ownership of a block will be determined by tracing the chain of ownerships, where applicable, to the third level of arms-length ownership. (see Figure 1, page 4)

Figure 1 - CHAIN OWNERSHIP

(assuming arms length chains)

Full COR	<hr/> Co. A	- COR applicant (1st level)
	<hr/>	
Simplified COR	<hr/> Co. B	- 2nd level of ownership
	<hr/>	
FIRA COR	<hr/> Co. C	- 3rd level of ownership
	<hr/>	

- (ii) At the first level of ownership the procedures in 2 above prevail. At the second level of ownership it would be necessary to select a least 25% of the outstanding ownership interests of the class with Canadian addresses in order of magnitude. This selection must include all ownership interests equal to or greater than 5% (a block) (see Appendix I - 4,5).
- (iii) At the third level of ownership, if the owner of a block is a corporation, trust or partnership a certificate will be provided by a prescribed officer, trustee or partner as applicable to the effect that, to the best of his information, knowledge and belief, the owner is Canadian controlled as provided for under the Foreign Investment Review Act. Such certificate will be accepted by the PMA for the purpose of the COR determination of the applicant, but for no other purpose. At this third level, if the owner of a block is an individual, Canadian addresses will be accepted for the purpose of this determination, but for no other purpose.
- (iv) Notwithstanding that Figure 1 illustrates three levels of COR calculation, the highest level of COR determination must be used where available. For example, where a company has determined a COR at the first level of ownership for other purposes, it must use this determination in all instances.

4. The COR of any class at any particular time would be computed by the following formula:

$$COR = \frac{R + (R/B \times S)}{I}$$

Where:

I = The total ownership interests issued or deemed to be issued and outstanding in that class.

B = The aggregate of the following ownership interests in that class:

- 1) Any block representing more than 0.5% of the total ownership interests, excluding all ownership interests with foreign addresses;
- 2) At least 50% of the ownership interests, after excluding all interests having foreign addresses, which may be extended beyond 50% at the option of the applicant; and
- 3) All blocks of ownership interests, identified above ranked in order of magnitude beginning with the largest block.

R = The Canadian beneficial ownership of B

S = The ownership interests of the class after deducting those with foreign addresses and those included in B.

Figure 2 - (opposite) illustrates the calculations required in a simple case.

Appendix III illustrates the calculations required in a more complex case.

C. Administrative Comments

The documentary requirements needed to support an application are set out in Appendix II. This documentation would be filed with the PMA in Ottawa. Upon review by the Agency a certificate would be issued in the name of the applicant setting out its COR and where applicable certifying whether the applicant is Canadian controlled. If it is determined that an applicant does not have Canadian control the PMA will so state in the COR certificate.

Figure 2 - BASIC CALCULATION

Assumptions:

- 1) Canadian corporation with 2,000,000 common shares of one class, issued and outstanding.
- 2) Shares with foreign addresses are 400,000.

$$\text{COR Corporation A} = \frac{750,000 + \left(\frac{750,000}{800,000} \times 800,000 \right)}{2,000,000} = 75\%$$

Where:

I = 2,000,000 shares outstanding

B = 800,000 shares.

Being 2,000,000 shares = I above
 (400,000) = foreign addresses
 1,600,000

It is assumed that the .5% blocks aggregate exactly 800,000 shares.

R = 750,000 shares being the Canadian beneficial ownership of B

S = 800,000 shares unidentified

Being 2,000,000 shares = I above
 (400,000) = foreign addresses
 (800,000) = B above
 800,000

Applications will be accepted as soon as enabling legislation has been passed. Applications received in January or February of any year shall, upon issue of a certificate, be effective from January 1 of that year and shall be in effect for a period of twelve months from January 1 of that year. Applications in other months will be effective, upon issue of a certificate, from date of forwarding to the PMA for a period of twelve months. Information supplied in support of an application shall be valid as of a date not earlier than 60 days prior to date of forwarding to the PMA.

An applicant or a holder of a certificate must notify the Agency in writing in the following circumstances:

1. Where there is a reduction or series of reductions of which he could reasonably be held to have knowledge, resulting in a COR change of 5 percentage points or more where such change would reduce the applicant's or holder's COR below either the 50% or 75% threshold levels (i.e. Petroleum Incentives Program, Canada Lands).
2. Where that applicant or holder is no longer Canadian controlled.
3. Where, in the case of an individual who is an applicant or a holder, his status has changed.

A holder of a certificate may apply to the Agency at any time for a revised certificate where there has been an increase in his COR or a change in control status.

An applicant will only be held responsible for information he himself supplies. Information respecting determinations supplied by another party will not be the responsibility of the applicant but rather that of the party supplying the information. Provision will be made for an audit process respecting information supplied.

Information supplied to PMA will be kept confidential except to the extent that:

- (i) COR determinations will be supplied to other agencies of government as required to implement government programs;
- (ii) The COR and control status of applicants, other than individuals, will be made public.

The PMA recognizes that COR could be an important factor in the planning, budgeting or investment decision making process. In response to this and a perceived need for COR related information affected by proposed transactions, an advance ruling facility will be provided.

III. CONTROL

In addition to the measurement of COR the PMA will also determine, where applicable, whether an applicant (other than an individual) is Canadian controlled. The PMA will make such determination as provided for under the Foreign Investment Review Act. Partnerships and trusts will be measured for control purposes as if the beneficial holders of ownership interests therein were shareholders in a corporation. The general partner (or general partners) of a limited partnership must be eligible for a COR if the limited partnership is to qualify for control. A corporation holding a current opinion from the Foreign Investment Review Agency confirming that it is Canadian controlled will be deemed Canadian controlled by the PMA.

APPENDIX I

Explanatory Comments, COR

1. A class includes:

- (i) Preferred or common shares
- (ii) Debt where it is in a form that represents effectively an equity investment.
- (iii) Partnerships would be evaluated to determine if any of the profit or loss sharing ratios of the partners differed from their capital interests.

If the income interest of the partners is the same as their respective capital interest the COR is as determined with respect to a corporation.

If the income interests are different than the capital interests then the COR would be calculated on the lowest of either the income or capital interests.

Where the ratio of capital or income interests of the partners under the terms of the partnership agreement could change in the future, a COR would be calculated on each possible change to determine the lowest interest in income or capital. These calculations would not be carried out, however, unless it is clear from the partnership agreement that the impact of these future changes would be so substantial as to represent a significant restructuring of the partnership.

- (iv) Trusts would be treated in a manner similar to partnerships with the basis for class determination being each combination of capital and income beneficiaries.
- (v) The various registered plans as described in Division G of the Income Tax Act would have a 100% Canadian content.
- (vi) If an applicant has more than 15% of its resource profits, (computed for purposes of the resource allowance under the Income Tax Act prior to adjustment for freehold or overriding royalties), paid or payable as a royalty or equivalent to non-residents, then those royalties would be treated as a separate class.
- (vii) A production payment established on or after October 28, 1980 would be deemed to be a royalty or equivalent where it effectively permits the holder to materially participate in the benefits accruing to the payor in relation to the economic life of the property upon which it is based.
- (viii) Where there are warrants, rights, options or similar instruments enabling the holder to acquire ownership interests, they will be deemed to have been exercised where the exercise would result in a lower COR unless the ownership interests to be issued on the exercise of all such warrants, rights, options or similar instruments is less than 5% of the total ownership interests.
- (ix) Preferred shares which are not convertible, not participating beyond a prescribed rate and redeemable at a premium equal to not more than the annual dividend rate, would be excluded for the purposes of this calculation.

2. (i) In the determination of classes it is the intent of the PMA not to segregate ownership interests or deemed interests into separate classes unless there are significant differences in the terms, conditions or rights between the interests (i.e. voting, non-voting).

(ii) Ownership interests deemed to be a separate class but not material in terms of their beneficial interest in the assets of the applicant may be either excluded or included with another class as appropriate.
3. In measuring COR, ownership interests with foreign addresses will be deemed to be foreign owned unless the contrary can be established.
4. In measuring COR, should an applicant wish to include blocks in addition to the required number he could do so provided he included all ownership interests equal to or greater than the lowest percentage ownership so included.
5. Any blocks or other ownership interest, not having a foreign address, selected for the purpose of a COR measurement that cannot be categorized, are non-traceable or do not reply in a timely manner, would be assigned 0% Canadian content.
6. Information which is material to changes in COR, including prospectuses covering issues of debt or equity instruments by the holder of a COR certificate, is to be filed with the Agency for purposes of advice only.

APPENDIX II

Documenting of COR

Documentation will be required as follows:

- 1) Audited financial statements as of the applicant's fiscal year end, where ordinarily prepared; otherwise a set of financial statements is to be submitted complying with the presentation standards as set out by the Canadian Institute of Chartered Accountants in its "Handbook".
- 2) If a corporation, confirmation of the total preferred and common shares outstanding by class or series together with any convertible instruments, in instances where unaudited statements are ordinarily prepared. Such confirmations to be supplied by the Corporate Secretary or equivalent of the applicant.
- 3) Statement of citizenship.
- 4) Residency declaration.
- 5) Declaration as to status under the Immigration Act.
- 6) Documentation to support the beneficial ownership aggregations of the applicant for each class or type of ownership interest in prescribed form.
- 7) Full details describing the terms of all warrants, rights, options and like instruments, as well as debt instruments convertible into any form of beneficial equity participation.
- 8) The detailed COR calculation in prescribed form.

- 9) Where the effective date of application is in excess of 60 days of the financial year end, a document signed by a prescribed official of the applicant, stipulating any significant events to the date of application, impacting upon the financial statements of the applicant.
- 10) Such other information as may be prescribed by regulation or required by the Minister or his designated representative from time to time to clarify specific aspects of an application.

APPENDIX III

Example of COR Calculation

Facts:

- 1) Company 'A' was incorporated in Canada.
- 2) Company 'A' is public and trades on the Vancouver and Toronto Stock Exchanges.
- 3) For purposes of this calculation the following assumptions have been made as at December 31:
 - (i) Debentures convertible into 300,000 Class 'B' common shares (acquired by Canadian beneficial interests as security for working capital loan to fund ongoing oil and gas activities and would therefore not be considered since the COR would not be lowered.)
 - (ii) 600,000 preferred shares convertible on the basis of 5 Class 'A' common shares for each preferred share. (These do not represent a separate ownership interest in this example.)
 - (iii) 500,000 Class 'A' voting common shares issued and outstanding.
 - (iv) 60,000 Class 'B' voting common shares issued and outstanding.
 - (v) 200,000 share purchase warrants convertible into Class 'B' common shares on a 1 for 1 basis, issued and outstanding. (These are deemed to be held in the same proportions as the Class "B" common shares, therefore are not considered in this example as they would not lower the COR.)
- 4) In this example it is considered that there is no significant difference between the "A" and "B" shares. As a result the COR calculation will treat the "A" and "B" shares as one issue of 560,000 shares.

COR of a Class

Description of Class:

Class 'A' and 'B' Common

Number of Shares of Class Issued:

560,000 (I)

Shares Identified:

Number of Shares with Foreign Addresses

187,000 (f)

Number of Shares with Canadian Addresses

<u>Shares per Block</u>		<u>COR of Ownership</u>		<u>Extension</u>
100,000	X	1.00	=	100,000
50,000	X	.75	=	37,500
50,000	X	.45	=	22,500
50,000	X	1.00	=	50,000
20,000	X	.75	=	15,000
6,000	X	.25	=	1,500
5,000	X	1.00	=	5,000
5,000	X	.90	=	4,500
<u>286,000</u>	(B)			<u>236,000</u> (R)

Note: (B) must be at least 50% of I-f and include all blocks equal to or greater than 0.5% of I.

Shares Not Identified:

Shares of Class Issued		<u>560,000</u> (I)
Less: Foreign Addresses	<u>187,000</u> (f)	
Canadian Addresses	<u>286,000</u> (B)	<u>473,000</u>
		<u>87,000</u> (S)

COR of Class = $\frac{R + (R/B \times S)}{I}$

$$= \frac{236,000 + (236,000 \times 87,000)}{560,000} = .5496$$

Classification "A" and "B" common = 54.96% COR.

